

IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO

DIVISION OF FINANCIAL MANAGEMENT

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The current General Fund revenue forecast for FY 2003 is \$176.7 million lower than the original Executive forecast of \$1,944.2 million that was released in December 2001. This reduction is due to a combination of a lower starting point (the \$123.7 million revenue shortfall in FY 2002), and an expectation that revenue growth in FY 2003 will be lower than was anticipated last December (3.9% currently forecast vs. 6.6% forecast last December).

The bulk of the revenue shortfall in FY 2002 occurred in the individual income tax, where an expected decline of 8.2% turned out to be an actual decline of 18.4%. This accounts for \$104.3 million (almost 85%) of the FY 2002 shortfall. The corporate income tax contributed \$17.1 million to the FY 2002 revenue shortfall. Last December it was expected to decline 34%, but it actually fell 46.1%.

Sales tax revenue was forecast to grow 1.9% in FY 2002, but it managed to gain only 1.5%. This added \$2.2 million to the FY 2002 revenue shortfall. Product and Miscellaneous revenues were almost exactly on target.

Not surprisingly, for FY 2003 the largest reduction to the revenue forecast is in the individual and corporate income taxes. Last December the individual income tax was forecast to grow 8.8% to \$1,022.8 million. It is now forecast to grow 6.6% to \$890.9 million, a \$131.9 million reduction. The corporate income tax was forecast to grow 20.1% to \$112.2 million, but is now forecast to increase only 7.2% to \$81.8 million. This contributes \$30.4 million to the FY 2003 revenue forecast reduction.

Together, the individual and corporate income taxes account for \$162.3 million, or 92% of the downgrade in the FY 2003 General Fund revenue forecast.

Volatility such as that seen in FY 2002 is not unusual in the corporate income tax, but is highly unusual in the individual income tax. Furthermore, understanding the actual magnitude of what happened in FY 2002 is complicated by the fact that major structural changes to the individual and corporate income taxes were enacted in the 2000 and 2001 legislative sessions. Those structural changes make it impossible to directly compare income tax revenue in FY 2000 through FY 2003.

In order to use econometric methods to produce the current income tax revenue forecast, the Division of Financial Management "normalized" the income tax revenue history by making adjustments for the estimated impacts of recent law changes. This normalized history is our best estimate of the actual revenue the State of Idaho would have received had the income tax laws not been changed. While done to facilitate econometric analysis of the income tax, this exercise also sheds considerable light on the unusual nature of FY 2002 individual income tax revenue.

Table 1 presents actual General Fund revenue for the period FY 1992 through FY 2002, and the current forecast for FY 2003. Table 2 provides alternative numbers for FY 2001-FY 2003 that have had the impacts of the structural changes to the income tax removed. In essence, Table 2 presents the revenue we think would have been received (and forecast) had the income

tax law changes of 2000 and 2001 not happened. While a thorough discussion of these changes is beyond the space limitations of this publication, a few particularly salient features deserve mention.

Without the law changes, total General Fund revenue growth would have been 1.6 percentage points higher in FY 2001, 5.6 percentage points higher in FY 2002, and 2.4 percentage points lower in the forecast for FY 2003. The stunning point here is that even without law changes total General Fund revenue would have declined 8.7% in FY 2002. This revenue collapse is primarily attributable to the 10.0% estimated decline in normalized individual income tax. The corporate income tax decline further aggravated the FY 2002 revenue situation.

Idaho's economy, which grew more slowly in 2001 than it has for over a decade, does not begin to explain the sharp decline in income tax revenue in FY 2002. Income tax revenue in FY 2002 was derived primarily from economic activity that occurred in tax year 2001. In Idaho, total nonfarm employment grew 1.5% and total personal income grew 3.9% in 2001. This economic performance is consistent with income tax growth, not decline.

The most likely explanation for the decline experienced in FY 2002 is in capital gains. Capital gains are part of the income tax base, but are not counted as a part of personal income. The dramatic decline in the stock markets that began in 2000 is the most likely culprit behind Idaho's revenue performance in FY 2002. (Continue on back)

SOURCE	ACTUAL										FORECAST	
	FY1992	FY1993	FY1994	FY1995	FY1996	FY1997	FY1998	FY1999	FY2000	FY2001	FY2002	FY2003
INDIVIDUAL INCOME TAX	\$459.44	\$508.02	\$559.17	\$596.46	\$650.85	\$704.82	\$776.19	\$841.86	\$960.16	\$1,023.97	\$835.85	\$890.94
% Change		6.3%	10.6%	10.1%	6.7%	9.1%	8.3%	10.1%	8.5%	14.1%	-18.4%	6.6%
CORPORATE INCOME TAX	\$67.97	\$70.00	\$87.63	\$131.64	\$151.98	\$122.36	\$117.29	\$95.44	\$124.87	\$141.63	\$76.30	\$81.80
% Change		-3.4%	20.8%	25.2%	50.2%	15.5%	-19.5%	-4.1%	-18.6%	30.8%	13.3%	7.2%
SALES TAX	\$364.32	\$402.82	\$452.68	\$481.57	\$463.00	\$476.73	\$496.81	\$588.80	\$627.50	\$647.29	\$657.12	\$673.17
% Change		8.5%	10.6%	12.4%	6.4%	-3.9%	3.0%	4.2%	18.5%	6.6%	3.2%	2.4%
PRODUCT TAXES	\$14.43	\$14.40	\$15.08	\$14.99	\$15.57	\$15.73	\$15.84	\$15.76	\$15.96	\$20.70	\$21.02	\$21.63
% Change		1.9%	-0.2%	4.7%	-0.6%	3.9%	1.0%	0.7%	-0.5%	1.2%	29.7%	1.5%
MISC. REVENUE	\$56.89	\$48.47	\$58.73	\$63.69	\$69.70	\$72.47	\$76.28	\$82.89	\$93.16	\$161.15	\$110.14	\$99.91
% Change		-6.1%	-13.3%	21.2%	8.5%	9.4%	4.0%	5.2%	8.7%	12.4%	62.2%	-9.3%
TOTAL GENERAL FUND REVENUE	\$952.05	\$1,043.71	\$1,173.29	\$1,288.35	\$1,351.09	\$1,392.11	\$1,482.41	\$1,624.75	\$1,821.66	\$1,984.65	\$1,700.43	\$1,767.44
% Change		5.6%	9.6%	12.4%	9.8%	4.9%	3.0%	6.5%	9.6%	12.1%	-14.3%	3.9%

Table 1 - Actual

	NORMALIZED		FORECAST	
	FY2001	FY2002	FY2003	
INDIVIDUAL INCOME TAX	\$1,050.77	\$945.79	\$970.90	
% Change		9.4%	-10.0%	2.7%
CORPORATE INCOME TAX	\$143.63	\$103.70	\$100.20	
% Change		15.0%	-27.8%	-3.4%
SALES TAX	\$647.29	\$657.12	\$673.17	
% Change		3.2%	1.5%	2.4%
PRODUCT TAXES	\$20.70	\$21.02	\$21.63	
% Change		29.7%	1.5%	2.9%
MISC. REVENUE	\$161.15	\$110.14	\$99.91	
% Change		62.2%	-27.1%	-9.3%
TOTAL GENERAL FUND REVENUE	\$2,013.55	\$1,837.77	\$1,865.81	
% Change		10.5%	-8.7%	1.5%

Table 2 - Normalized

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General Fund Update

As of July 31, 2002

Revenue Source	\$ Millions		
	FY03 Executive Estimate ³	DFM Predicted to Date	Actual Accrued to Date
Individual Income tax	890.9	62.9	61.4
Corporate Income tax	81.8	3.7	3.4
Sales Tax	673.2	59.8	63.0
Product Taxes ¹	21.6	1.9	1.8
Miscellaneous	99.9	10.1	10.2
TOTAL GENERAL FUND²	1,767.4	138.4	139.8

¹ Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
² May not total due to rounding
³ Revised Estimate as of August 2002

General Fund revenue was \$1.4 million (1.0%) higher than expected in July, the first month of fiscal year 2003. Almost the entire gain was due to strong sales tax collections, which offset modest weakness in the individual and corporate income taxes. Product taxes and miscellaneous revenues both came in very close to their targets, and combined they were exactly on the mark.

Individual income tax revenue was \$1.5 million (2.4%) lower than expected in July. On the collection side, filing payments were \$0.9 million higher than predicted and withholding collections were \$1.7 million lower than predicted. On the payout side, refunds were \$1.7

million higher than expected and miscellaneous diversions were \$0.9 million lower than expected. The modest weakness in withholding collections is not a cause for concern, since the underlying economic forecast anticipates modest but accelerating job growth in Idaho over the next year. This implies that withholding performance should be stronger in the latter stages of the fiscal year.

Corporate income tax revenue was \$0.3 million (8.1%) lower than expected in July. Filing payments were \$0.4 million higher than predicted for the month, while quarterly estimated payments were \$0.1 million lower than predicted. Refund payments were \$0.6 million higher than expected for the month.

Sales tax revenue was \$3.2 million (5.4%) higher than expected in July. Unlike income tax withholding, sales tax is expected to soften in the months ahead as the impacts of low mortgage rates and zero percent auto finance rates wane. Sales tax collections in July grew by 5.0% over the same month a year earlier, whereas sales tax is expected to grow by a more modest 2.4% for the full fiscal year. While this may appear to be unusually slow growth, it is 60% faster than FY 2002's actual sales tax growth of 1.5%.

Product and miscellaneous revenue were each off by a mere \$0.1 million in July (but in opposite directions), yielding no variance when the two categories are combined.

(Continued from front)

While the current fiscal situation is unpleasant, there is at least some solace in the knowledge that Idaho's fiscal problems are not the result of Idaho's economy failing to perform. Rather, they are primarily the result of the national and global financial meltdown. Unfortunately, this means we are to a significant degree at the mercy of these outside forces when it comes to a recovery in the revenue stream. The current forecast for FY 2003 contemplates another difficult year (tax year 2002) for capital gains, but this means the impact from this component of the income tax base is neutral. Very modest individual income tax growth forecast for FY 2003 comes from increases in Idaho wages and business income anticipated in 2002.